**Cost Behaviours and The Contribution Approach**

Remember:

Fixed costs remain the same regardless the level of business activity you experiences. Variable costs will fluctuate based on the amount of business activity you experience and mixed cost have both a variable and fixed characteristics.

Cost behavior refers to the way a cost changes (behaves) in relation to changes in an activity level.

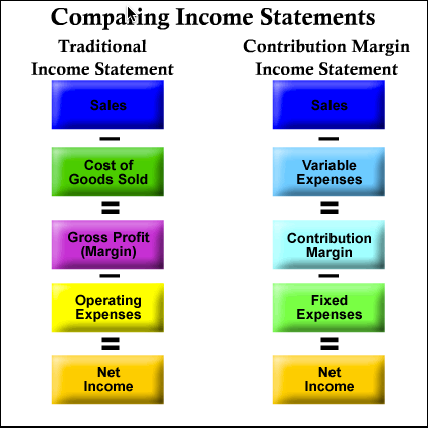
Why are cost behaviours important to the manager? The manager must plan and control variable, fixed, and mixed costs and needs cost data organized to facilitate management decision-making process.

How can cost information be organized to facilitate management decision making? A new format for the income statement called the contribution margin income statement is completed. The contribution approach to the income statement organizes information in terms of cost behaviour. A contribution margin income statement is an income statement in which all [variable expenses](http://www.accountingtools.com/questions-and-answers/what-is-a-variable-cost.html) are deducted from sales to arrive at a [contribution margin](http://www.accountingtools.com/contribution-margin), from which all [fixed expenses](http://www.accountingtools.com/questions-and-answers/what-is-a-fixed-cost.html) are then subtracted to arrive at the net profit or loss for the period. Thus, the arrangement of expenses in the income statement corresponds to the nature of the expenses. This income statement format is a superior form of presentation, because the contribution margin clearly shows the amount available to cover fixed costs and generate a profit (or loss).

In essence, if there are no sales, a contribution margin income statement will have a zero contribution margin, with fixed costs clustered beneath the contribution margin line item. As sales increase, the contribution margin will increase in conjunction with sales, while fixed costs remain (approximately) the same. A contribution margin income statement varies from a normal income statement in the following three ways:

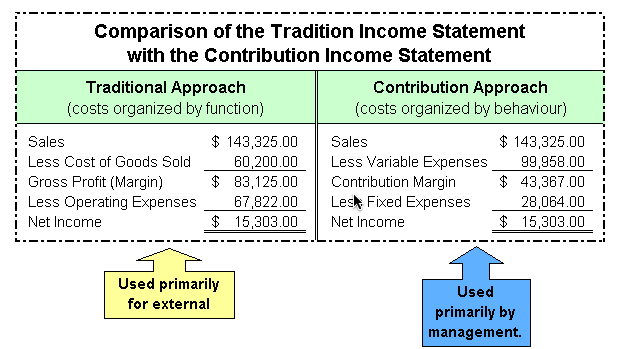
* Fixed production costs are aggregated lower in the income statement, after the contribution margin;
* Variable selling and administrative expenses are grouped with variable production costs, so that they are a part of the calculation of the contribution margin; and
* The [gross margin](http://www.accountingtools.com/definition-gross-margin) is replaced in the statement by the contribution margin.

Below is the traditional income statement which is compared with the Contribution style income statement.



How do these compare?

|  |  |
| --- | --- |
| **Traditional  Income Statement** | **Contribution Margin  Income Statement** |
| - more functional | - geared at cost behaviours |
| - more general | - can be specific to individual aspects (ex - cost of making/selling CDs) |
| - for the public | - for the managers |
| - "big picture" | - smaller parts of the "big picture" |



**Contribution Income Statement Assignment**

1. What is the difference between the Contribution Income Statement and the Traditional Income Statement?
2. How are each organized or classified by?
3. For whom is the Traditional Income Statement and Contribution Income Statement completed for? Or who is the one that uses them to interpret their data.
4. Fill in the blanks below

|  |  |
| --- | --- |
| Sales | 35 000 |
| Less \_\_\_\_\_\_\_\_\_\_\_\_\_ |  |
| = \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ | 25 000 |
| Less \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ | 10 000 |
| = |  |

|  |  |
| --- | --- |
|  |  |
|  | 10 000 |
|  | 15 000 |
|  |  |
|  | 3 000 |